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061211Z Oct 05

C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 003000

SIPDIS

ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD

E.O. 12958: DECL: 10/05/2015

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SUBJECT: THE TRANSITION TO JOINT VENTURES: BAD TO WORSE

REF: CARACAS 02387

Classified By: Economic Counselor Andrew Bowen for Reason 1.4 (D)

SUMMARY

1. (C) SUMMARY: Energy Minister Rafael Ramirez raised the pressure last week on foreign oil companies holding Operating Service Agreements (OSAs) to migrate their contracts to joint ventures under the 2001 Hydrocarbons Law when he publicly threatened to take over OSA fields if the companies did not migrate their contracts to joint ventures by the end of the year. Petrobras promptly signed a transition agreement, and we fully expect additional companies to follow suit over the next two weeks. It is not clear what form the various transition agreements and the resulting joint venture contracts will take. It is also not clear what the GOV plans to do if joint venture contracts are not signed by the end of the year or if oil companies invoke their rights to international arbitration. END SUMMARY

MERRY CHRISTMAS AND HAPPY NEW YEAR

2. (C) Energy Minister Ramirez substantially raised the pressure on foreign oil companies with OSAs on September 26 when he publicly threatened to take over fields operated under OSAs if companies failed to migrate their contracts to joint ventures controlled by PDVSA by the end of the year. Ramirez also stated PDVSA must have at a minimum a 60 percent and at a maximum 80 percent stake in the new joint venture companies. On September 29, President Chavez and Petrobras President Jose Eduardo announced that Petrobras would sign a transition agreement to migrate its OSAs to joint venture companies. They also announced a joint venture to build a refinery in Pernambuco, Brazil, an agreement to develop four gas blocks in the Mariscal Sucre offshore project, an agreement for PDVSA to supply Petrobras with geological data for the quantification of reserves of a block in the Faja as well as joint exploration of the block, and information on four mature fields. A prominent energy attorney sarcastically told Petroleum Attache (PetAtt) that the decision to sign the transitory agreement made sense for Petrobras since they "received half the country" in exchange.

3. (C) As reported in Reftel A, four international operators (Harvest, Repsol, Hocoil, and Teikoku) and four local firms (Inemaca, Open, Suelopetrol, and Vincclair) signed transition agreements on August 4. A prominent local analyst, as well as an energy attorney at Macleod Dixon, (strictly protect) told PetAtt that additional companies will be signing transition agreements over the next two weeks. The analyst and attorney were not at liberty to reveal the firms' identities, but we were told that no U.S. companies were in the group. The analyst and attorney differed on the number of firms and fields that were involved.

4. (C) It is also not clear what form the various transition agreements and the resulting joint venture contracts will take. We were led to believe that the initial round of transition agreements that the eight firms signed were identical. The Macleod Dixon attorney told PetAtt that the agreements were different. In addition, partners at the law firm of Squire, Sanders & Dempsey (strictly protect) told PetAtt the oil companies have been divided into three basic groups: international oil companies (IOCs), national oil companies (NOCs), and local companies. The Squire Sanders attorneys said local companies would be given special treatment. The Macleod Dixon attorney also stated local companies would be given some sort of reward for signing the transition agreements. According to the Squire Sanders attorneys, the IOCs would face the harshest terms during negotiations. The Squire Sanders attorneys said the GOV originally stated the joint venture contracts would be standard for all of the companies. However, it appears the GOV has changed its mind and is now accepting proposals for language in the transition agreements and joint venture contracts. (NOTE: Squire Sanders recently merged with Miami firm Steel Hector & Davis. Steel Hector represented PDVSA for a number of years and Squire Sanders continues to represent them. The firm received a waiver from PDVSA that

allows them to represent oil companies in the transition agreement and joint venture negotiations. END NOTE)

15. (C) Both the Squire Sanders attorneys and the local analyst told PetAtt the GOV has said it will create Operational Transitional Committees composed of PDVSA and GOV officials that will be in charge of shepharding the transition from OSAs to joint ventures. It appears the transitional teams will be showing up at companies' offices within the next few weeks. No one seems to know what powers the committees will have. Given the fact that no one has signed a joint venture contract, it is not clear what "transition" the committees will be shepherding.

COALS AND SWITCHES

16. (C) Apart from PDVSA officials, we have yet to find anyone in the industry that believes the GOV and the oil companies will be able to reach an agreement on the myriad of legal and operational issues that the migration from OSAs to joint venture companies raise by year end. According to IOC documents that were supplied to PetAtt, major negotiation issues include operational issues such as employees and termination payments as well as labor unions; lack of definition regarding minority shareholder rights, commercialization, and property value assement; and any potential incentives for companies to migrate such as longer term contracts, payments in kind, and new additional areas if development plans show poor economies at the end of the joint venture contract.

17. (C) Some companies apparently were holding out hope that signing a transition agreement would give them extra time to negotiate the joint venture contracts. A Petrobras executive told PetAtt on September 27 that his company believed that to be true. We do not believe this is a reasonable hope. PDVSA Vice President Luis Vierma told the Economic Counselor and PetAtt on September 28 that all of the OSAs must migrate to joint ventures by the end of the year. Signing a transition agreement will not give companies additional time for negotiation. Squire Sanders attorneys confirmed that senior PDVSA officials have told them the same thing.

18. (C) The obvious question is what happens when December 31 arrives and a company has not signed a contract to migrate its OSA to a joint venture. The general opinion among private sector players is that companies that have signed a transition agreement will be treated better than those who have not signed. However, no one knows what types of sanctions will be applied to either group. The Macleod Dixon attorney believes that one or more companies will not sign either document and will elect to take the GOV to arbitration. The attorney was not sure what would happen if a company elected to pursue arbitration.

19. (C) Failure to sign a joint venture agreement by year end also raises a number of operational issues. If the OSAs do not migrate by year end, who will be operating the fields on January 1? The local analyst hypothesized that PDVSA may create some sort of transitional mixed companies to carry out operations until the permanent joint venture is formed. The analyst believes the Operational Transitional Committees may have a some sort of governing role in the transitional joint venture. The Macleod Dixon attorney also thought this may be a possibility and stated the GOV would have to come up with some sort of transitional mechanism. The attorney raised another possibility: the GOV may let the oil companies continue operating the fields but refuse to pay them. By withholding payment, the GOV could "bleed" the companies into submission. The attorney pointed out the GOV has repeatedly said there will be no funds for the OSAs in the 2006 PDVSA budget.

CONCLUSION: WHERE IS RUDOLPH WHEN YOU NEED HIM

10. (C) The rumor mill is presently operating full blast in the oil sector. Between Ramirez's September 26 comments and the fact the oil companies will be receiving tax bills based on GOV audits in the next few weeks, the only thing that is certain is more uncertainty between now and year end. Post will continue to monitor the situation.
Brownfield